

CITY OF TERRELL, TEXAS

ANNUAL FINANCIAL REPORT

SEPTEMBER 30, 2006

CITY OF TERRELL, TEXAS

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INTRODUCTORY SECTION

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April 13, 2007

The Honorable Mayor and Members of the City Council
City of Terrell
Terrell, Texas

The Finance Department and the City Manager's office are pleased to submit the basic financial statements for the City of Terrell, Texas (the "City") for the fiscal year ended September 30, 2006.

This report is published to provide the City Council, City staff, our citizens, our bondholders, and other interested parties with detailed information concerning the financial condition and activities of the City government. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the City.

To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is organized in a manner designed to fairly present the financial position and results of the City as measured by the financial activity of its various funds and account groups. We also believe that all disclosures necessary to enable the reader to gain the maximum understanding of the City's financial affairs have been included.

THE REPORT

This report is presented in three sections: Introductory, Financial and Single Audit. The introductory section includes this transmittal letter, a listing of the City officials, and an organizational chart of the City. The financial section includes Management's Discussion and Analysis (MD&A), basic financial statements and combining and individual fund statements and schedules, as well as the independent auditors' report on the basic financial statements. The MD&A is a narrative introduction, overview, and analysis to accompany the basic financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Terrell's MD&A can be found immediately following the report of the independent auditors. The Single Audit section contains a schedule of federal expenditures and reports required by the Federal Single Audit Act of 1996.

The financial section described above is prepared in accordance with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (GASB) and other professional associations, as applicable.

CITY PROFILE

Location

The City of Terrell, Texas is located on U. S. Highway 80 just north of Interstate 20, and approximately 32 miles east of Dallas, Texas. The City, encompassing approximately 18.6 square miles, had a 2000 census population of 13,600, which is a 9% increase from the 1990 census population of 12,490.

The City operates under the Council-Manager form of government. The City Council is comprised of the Mayor and four Council members, who enact local laws, determine policies and adopt the annual budget. The City Manager is appointed by the City Council and is responsible for the daily management of the City. The basic financial statements of the City include all government activities, organizations and functions for which the City is financially accountable as defined by the GASB. Based on these criteria, no other governmental organizations are included in this report.

Services Provided

The City provides to its citizens those services that have proven to be necessary and meaningful and which the City at the least cost can provide. Major services provided under general government and enterprise functions are: police and fire protection, water and sewer services, sanitation services, park and recreational facilities, library services, street improvements and general administrative services. The City also offers an airport. Internal services of the City accounted for on a cost reimbursement basis, are the fleet services operations and employee health coverage.

Accounting System and Budgetary Control

The City's accounting records for general governmental operations are maintained on a modified accrual basis, with the revenues being recorded when available and measurable and expenditures being recorded when the services or goods are received and the liabilities are incurred. Accounting records of the City's utilities and other proprietary activities are maintained on the accrual basis.

In developing and maintaining the City's accounting system, consideration is given to the adequacy of the internal control structure. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; and (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe that the City's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

The City charter provides that the City Council shall adopt the annual budget prepared by City Management. This budget is reviewed by the City Council and is formally adopted by the passage of a budget ordinance. The City Manager is authorized to transfer budgeted amounts between line items and departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the City Council.

Budgetary control has been established at the individual fund level. Financial reports are produced showing budget and actual expenditures by line item, and are distributed monthly to City departmental and divisional management and to others upon request.

Individual line items are reviewed and analyzed for budgetary compliance. Personnel expenditures are monitored and controlled at a position level and capital expenditures (items over \$5,000 and having a useful life of three or more years) are monitored and controlled item by item. Revenue budgets are reviewed monthly.

ECONOMIC OUTLOOK AND FINANCIAL CONDITION

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the City operates.

Terrell has a diversified industrial base consisting of manufacturers, distributors, and processors.

Two institutions of higher education are located here. They are Southwestern Christian College and Trinity Valley Community College.

The City activity works with the Terrell Economic Development Corporation and local industries to encourage expansions and relations to our community. Land is available for development and the area has an abundant water supply. Incentives are also available to facilitate business expansions or relocations.

The outlook is encouraging with industrial, commercial, and residential development expected to continue. The potential for sustained development is present, and many people are working to promote positive economic growth.

Economic signs...

	ASSESSED PROPERTY VALUATIONS (in millions)	SALES TAX COLLECTIONS (in millions)
2000	\$ 460,894,975	\$ 5,468,815
2001	506,373,987	5,662,562
2002	586,621,575	5,756,021
2003	603,618,789	6,008,287
2004	667,943,545	6,595,836
2005	736,093,827	6,683,382
2006	834,587,541	7,002,351

Cash Management

The City awards its depository contract through official bidding procedures for a three-year period, with an option to extend the contract for an additional two years. The current depository contract with American National Bank expires July 15, 2006.

The City has a services-only contract, where a minimum amount of cash is held in interest bearing checking accounts to meet the City's operational needs. The remaining idle cash is invested by City officials in securities as allowed by Texas Statutes and by the City's investment policy.

At September 30, 2006, all idle cash totaling \$4,074,599 was invested in certificates of deposit. The overall portfolio provided \$344,827 in interest income during the year.

It is the City's policy that all demand deposits and time deposits are secured by pledged collateral with a market value equal to no less than 100% of the deposits less an amount insured by the FDIC. The Finance Department and a third party financial institution maintains evidence of the pledged collateral. Collateral is reviewed monthly to assure the market value of the securities pledged equals or exceeds the related bank balances.

All safekeeping arrangements are in accordance with a safekeeping agreement approved by the City Manager that clearly defines the procedural steps for gaining access to pledge collateral on deposits should the City of Terrell determine that the City's funds are in jeopardy. The safekeeping institution, or Custodian, is the Federal Home Loan Bank or an institution not affiliated with the firm pledging the collateral. The safekeeping agreement is a three-party contract between the City, the depository bank and the Federal Home Loan Bank as Custodian. The security is held in the name of the depository bank on behalf of the City. The original copy of all safekeeping statements is delivered to the City.

All collateral is subject to inspection and audit by the City Secretary and the City's independent auditors.

Risk Management

Property and Liability Plans

The City is exposed to various risks of loss related to torts; damage to, and destruction of assets; errors and omissions and national disasters. A comprehensive insurance plan for property and casualty and general liability coverage has been established with the Texas Municipal League.

Workers' Compensation Plan

The City is exposed to risk of loss due to injuries by employees while performing work-related duties. The City provides workers' compensation insurance coverage with the Texas Municipal League, which provides statutory coverage against potential losses.

Health Plan

The City has established a self-insurance plan for health care benefits that pays 100% of employee claims limited to \$15,000 per employee and \$650,000 in aggregate. The City has insured claims in excess of plan limits.

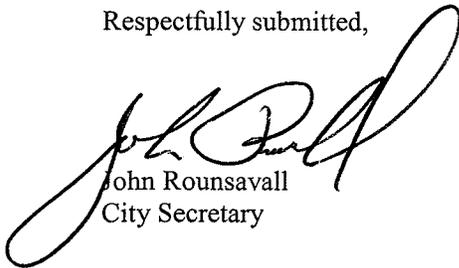
INDEPENDENT AUDIT

The City Charter requires an annual audit by independent certified public accountants. The accounting firm of Pattillo, Brown, & Hill, L.L.P. was selected by the City Council to perform the fiscal 2006 audit. In addition to meeting City Charter requirements, the audit also was designed to meet the requirements of the Federal Single Audit Act of 1996 and related OMB Circular A-133. The auditors' report on the basic financial statements is in the financial section.

ACKNOWLEDGEMENTS

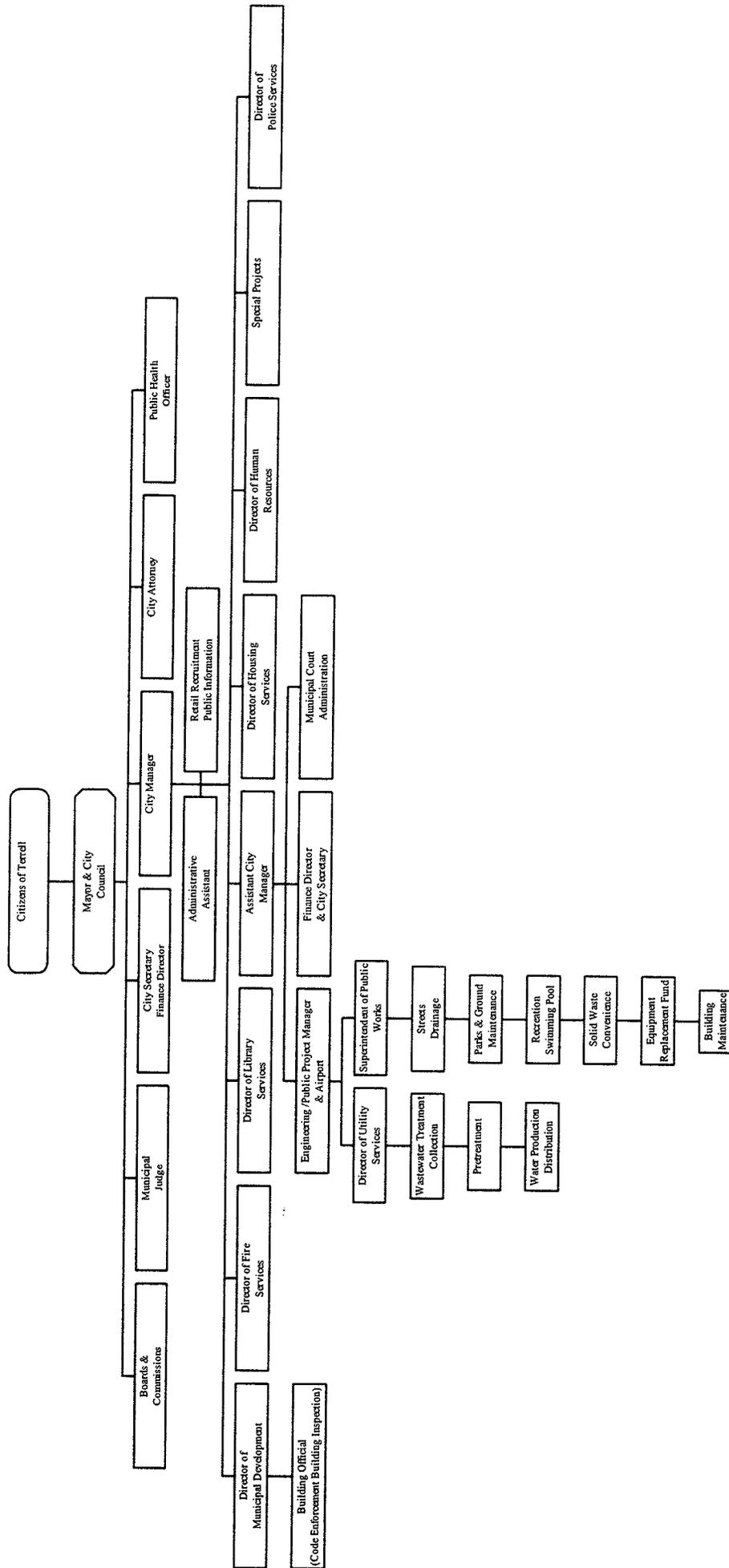
The preparation of this report could not be accomplished without the efficient and dedicated services of the entire staff of all City departments. We would like to express our appreciation to all members of the City's staff who assisted and contributed to its preparation. We would also like to thank the Mayor and City Council members for their interest and support in planning and conducting the financial operations of the City in a responsible and progressive manner.

Respectfully submitted,



John Rounsavall
City Secretary

City of Terrell Organizational Chart



CITY OF TERRELL, TEXAS

PRINCIPAL OFFICIALS

SEPTEMBER 30, 2006

CITY OFFICIALS

Mayor.....Hal Richards

Council Members..... Ricky Jordan, Mayor Pro-Tem

Jack Jones, Deputy Mayor Pro-Tem

Tommy Spencer

Don Thurman

City Manager Gordon Pierce

City Secretary..... John Rounsavall

City Attorney Mary Gayle Ramsey

FINANCIAL SECTION

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INDEPENDENT AUDITORS' REPORT

To the Honorable City Council
City of Terrell, Texas

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Terrell, Texas, as of and for the year ended September 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Terrell, Texas' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Terrell, Texas, as of September 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 13, 2007, on our consideration of the City of Terrell, Texas' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Terrell, Texas' basic financial statements. The introductory section and the combining fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations*, and is also not a required part of the basic financial statements of the City of Terrell, Texas. The combining fund financial statements and the Schedule of Expenditures of Federal Awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Pattillo, Brown + Hill, L.L.P.

April 13, 2007

**MANAGEMENT'S
DISCUSSION AND ANALYSIS**

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Management's Discussion and Analysis

As management of the City of Terrell, we offer readers of the City's financial statements this narrative overview and analysis of the financial activities for the fiscal year ended September 30, 2006. This discussion and analysis is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the City's financial activity, (c) identify changes in the City's financial position (its ability to address the next and subsequent years' challenges), (d) identify any material deviations from the financial plan (the approved budget); and (e) identify individual fund issues or concerns. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages i – iv of this report.

FINANCIAL HIGHLIGHTS

- The assets of the City of Terrell exceeded its liabilities at the close of the most recent fiscal year by \$45,019,532 (net assets). Of this amount, \$9,652,500 (unrestricted net assets) may be used to meet the City's ongoing obligations to citizens and creditors in accordance with the City's fund designation and fiscal policies.
- The City's total net assets increased by \$2,515,653.
- As of the close of the current fiscal year, the City of Terrell's governmental funds reported combined ending fund balances of \$15,334,943, an increase of \$1,238,674 in comparison with the prior fiscal year, due to proceeds received from the issuance of debt. Approximately 42% of this total amount, \$6,452,610, is available for spending at the City's discretion (unreserved fund balance).
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$5,197,322 or 36% of the total General Fund expenditures.
- The City's total long-term debt increased by \$871,126 during the fiscal year due to the issuance of \$1,570,000 in certificates of obligation.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The Statement of Net Assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The Statement of Activities presents information showing how the City's net assets changed during the fiscal year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in the future fiscal periods (e.g., uncollected taxes earned but unused and compensated absences).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from functions that are intended to recover all or a significant portion of their costs through user fees (business-type activities).

- Governmental activities include general government and administration, public safety, library, and parks and recreation.
- Business-type activities include the City's water and sewer system and airport operations. Charges for services covers all or most of the cost for these services.

The government-wide financial statements can be found on pages 11– 13 of this report.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Fund accounting is used by state and local governments to control and manage money for particular purposes and to ensure finance-related legal requirements. The City uses two fund types – governmental and proprietary.

- **Governmental funds** – Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statements of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains 15 governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balances for the General Fund, Section 8 Rent Supplement Fund, Terrell Economic Development Corporation Fund, and the C. O. Tax and Revenue Series 2004 Fund, each of which are considered to be major funds. Data from the other 11 funds are combined into a single, aggregated presentation.

The basic governmental funds financial statements can be found on pages 14 – 24 of this report.

- **Proprietary funds** – The City maintains two types of proprietary funds. Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses Enterprise Funds to account for its water, sewer and airport. Internal Service Funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses its Internal Service Funds to account for its fleet services and self-insurance. Because these services predominantly benefit governmental rather than business-type functions, it is included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water, Sewer, and Airport Funds since they are considered to be major funds of the City. All Internal Service Funds are combined into a single aggregated presentation in the proprietary fund financial statements. Individual fund data for the Internal Service Funds is provided in the form of combining statements elsewhere in this report.

The basic proprietary fund financial statements can be found on pages 21 – 24 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 25 – 46 of this report.

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees.

The combining statements referred to earlier in connection with Internal Service Funds are presented following the required supplementary information on pensions. Combining and individual statements and schedules can be found on pages 47 – 53 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of the City's financial position. In the case of the City of Terrell, assets exceeded liabilities by \$45,019,532 as of September 30, 2006.

The largest portion of the City's net assets, 57% (\$25,502,855), reflects its investments in capital assets (e.g., land, building, equipment, improvements, construction in progress and infrastructure), less any debt used to acquire those assets that are still outstanding. The City uses these capital assets to provide service to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

CITY OF TERRELL'S NET ASSETS

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Current and other assets	\$ 18,063,802	\$ 16,053,064	\$ 4,838,546	\$ 4,472,772	\$ 22,902,348	\$ 20,525,836
Capital assets	<u>20,617,483</u>	<u>19,605,292</u>	<u>29,220,174</u>	<u>28,133,687</u>	<u>49,837,657</u>	<u>47,738,979</u>
Total assets	<u>38,681,285</u>	<u>35,658,356</u>	<u>34,058,720</u>	<u>32,606,459</u>	<u>72,740,005</u>	<u>68,264,815</u>
Long-term liabilities	23,301,947	22,291,366	2,128,977	2,268,432	25,430,924	24,559,798
Other liabilities	<u>1,277,225</u>	<u>644,934</u>	<u>1,012,324</u>	<u>483,147</u>	<u>2,289,549</u>	<u>1,128,081</u>
Total liabilities	<u>24,579,172</u>	<u>22,936,300</u>	<u>3,141,301</u>	<u>2,751,579</u>	<u>27,720,473</u>	<u>25,687,879</u>
Net assets:						
Invested in capital assets, net of related debt	(1,647,319)	(1,936,189)	27,150,174	25,923,686	25,502,855	23,987,497
Restricted	9,647,430	9,018,899	216,747	294,974	9,864,177	9,313,873
Unrestricted	<u>6,102,002</u>	<u>5,639,346</u>	<u>3,550,498</u>	<u>3,636,220</u>	<u>9,652,500</u>	<u>9,275,566</u>
Total net assets	<u>\$ 14,102,113</u>	<u>\$ 12,722,056</u>	<u>\$ 30,917,419</u>	<u>\$ 29,854,880</u>	<u>\$ 45,019,532</u>	<u>\$ 42,576,936</u>

Analysis of the City's Operations

The following table provides a summary of the City's operations for the years ended September 30, 2006 and 2005.

CITY OF TERRELL'S CHANGES IN NET ASSETS

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues:						
Charges for services	\$ 2,232,819	\$ 2,702,638	\$ 7,739,591	\$ 8,688,384	\$ 9,972,410	\$ 11,391,022
Operating grants and contributions	4,663,465	4,482,733	-	-	4,663,465	4,482,733
Capital grants and contributions	-	-	-	311,338	-	311,338
General revenues:						
Property taxes	5,493,214	4,885,222	-	-	5,493,214	4,885,222
Franchise taxes	1,726,828	1,513,702	-	-	1,726,828	1,513,702
Sales taxes	7,002,351	6,683,382	-	-	7,002,351	6,683,382
Other taxes	235,195	173,719	-	-	235,195	173,719
Miscellaneous	278,335	126,523	66,492	20,954	344,827	147,477
Gain on sale of assets	284,098	211,486	379,325	-	663,423	211,486
Transfers	-	442,531	-	(442,531)	-	-
Total revenues	21,916,305	21,221,936	8,185,408	8,578,145	30,101,713	29,800,081
Expenses:						
General government	5,896,460	5,518,792	-	-	5,896,460	5,518,792
Public safety	6,103,070	5,380,118	-	-	6,103,070	5,380,118
Streets	2,671,672	2,403,168	-	-	2,671,672	2,403,168
Sanitation	502,107	456,663	-	-	502,107	456,663
Culture and recreation	709,433	1,010,405	-	-	709,433	1,010,405
Public welfare	3,733,149	2,786,831	-	-	3,733,149	2,786,831
Interest on long-term debt	920,357	815,099	-	-	920,357	815,099
Water and sewer	-	-	6,669,564	5,890,256	6,669,564	5,890,256
Capital projects	-	-	-	8,500	-	8,500
Airport	-	-	380,248	433,345	380,248	433,345
Total expenses	20,536,248	18,371,076	7,049,812	6,332,101	27,586,060	24,703,177
Change in net assets	1,380,057	2,850,860	1,135,596	2,246,044	2,515,653	5,096,904
Net assets, beginning	12,722,056	9,871,196	29,781,823	27,535,779	42,503,879	37,406,975
Net assets, ending	\$ 14,102,113	\$ 12,722,056	\$ 30,917,419	\$ 29,781,823	\$ 45,019,532	\$ 42,503,879

Governmental activities. Of the City's \$2,515,653 overall increase in net assets, governmental activities net assets increased by \$1,380,057. The most significant governmental expense for the City was in providing public safety, which incurred expenses of \$6,103,070. These expenses were funded by revenues collected from a variety of sources, with the largest being from sales taxes, which are \$7,002,351 for the fiscal year ended September 30, 2006. Other significant governmental expenses for the City include general government, which incurred \$5,896,460 in expenses, and \$766,007 in economic development expenses.

Business-type activities. Business-type activities increased the City's net assets by \$1,135,596.

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

Governmental Funds

The focus of the City of Terrell's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At the end of the current fiscal year, the City of Terrell's governmental funds reported combined ending fund balances of \$15,334,943. Approximately 42% of this total amount (\$6,452,610) constitutes unreserved fund balance. The remainder of the fund balance is reserved to indicate that it is not available for new spending because it has already been committed to (1) pay for capital projects (\$6,942,180), (2) pay for debt service (\$338,013), (3) pay for investments held for resale (\$1,442,530), and (4) other miscellaneous reservations (\$159,610).

In the General Fund, the City budgeted for a decrease in the fund balance of \$2,108,331. Actual revenues being more than budgeted, the actual fund balance decreased for fiscal year 2006 by \$111,244.

Proprietary Funds

The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

Net assets of the respective proprietary funds are the Water and Sewer Fund, \$22,590,925; and the Airport Fund, \$8,326,494. The Water and Sewer Fund's net assets increased in 2006 by \$1,336,768 and the Airport's net assets decreased by \$201,172.

General Fund Budgetary Highlights

The City made revisions to the original appropriations approved by the City Council. Overall, these changes resulted in an increase of budgeted General Fund expenditures from the original budget of \$15,814,852.

The City had budgeted for little or no increase in most revenue categories from the prior year collections based on economic conditions. However, actual revenues exceeded the budgeted revenue amount by \$58,493.

CAPITAL ASSETS

The City of Terrell's investment in capital assets for its governmental and business-type activities as of September 30, 2006, amounts to \$49,837,657 (net of accumulated depreciation). This investment in capital assets includes land, building, equipment, improvements, infrastructure and construction in progress.

More capital asset events during the current fiscal year included the following:

- \$643,594 was spent on land to be used for governmental purposes;
- \$3,236,302 was completed on various governmental and business-type construction projects that continue to be in progress; and
- \$514,932 was spent on various equipment, such as vehicles, work equipment and vehicle video cameras.

**CITY OF TERRELL'S CAPITAL ASSETS AT YEAR-END
Net of Accumulated Depreciation**

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Land	\$ 665,035	\$ 137,200	\$ 885,019	\$ 885,019	\$ 1,550,054	\$ 1,022,219
Buildings and improvements	2,450,152	2,579,547	7,551,053	11,939,945	10,001,205	14,519,492
Machinery and equipment	2,381,161	2,335,510	16,775,096	13,208,480	19,156,257	15,543,990
Infrastructure	13,198,741	13,958,180	-	-	13,198,741	13,958,180
Construction in progress	1,922,394	594,855	4,009,006	2,100,243	5,931,400	2,695,098
Total capital assets	<u>\$ 20,617,483</u>	<u>\$ 19,605,292</u>	<u>\$ 29,220,174</u>	<u>\$ 28,133,687</u>	<u>\$ 49,837,657</u>	<u>\$ 47,738,979</u>

Additional information on the City of Terrell's capital assets can be found in Note 4 on pages 37 – 38 of this report.

DEBT ADMINISTRATION

At the end of the current fiscal year, the City of Terrell had a total bonded debt of \$18,850,000. Of this amount, \$18,165,000 comprises bonded debt backed by the combination of property tax and water/sewer revenues and \$685,000 represents bonds secured solely by water and sewer revenues.

CITY OF TERRELL'S OUTSTANDING DEBT AT YEAR-END

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
General obligation bonds	\$ 3,095,000	\$ 3,470,000	\$ -	\$ -	\$ 3,095,000	\$ 3,470,000
Certificates of obligation	13,685,000	12,630,000	1,385,000	1,440,000	15,070,000	14,070,000
Revenue bonds payable	-	-	685,000	770,000	685,000	770,000
	<u>\$ 16,780,000</u>	<u>\$ 16,100,000</u>	<u>\$ 2,070,000</u>	<u>\$ 2,210,000</u>	<u>\$ 18,850,000</u>	<u>\$ 18,310,000</u>

During the current fiscal year, the City's total bonded debt increased by \$540,000 or 3%. The main reason for the increase was the issuance of the Tax and Waterworks and Sewer System Revenue Certificates of Obligation, Series 2006 in the amount of \$1,570,000.

The City's bond ratings are listed below:

	<u>Moody's Investors Service</u>	<u>Standard & Poor's</u>
General Obligation Bonds	Aaa	AA
Revenue Bonds	Aaa	AA

Several of the City's bonds are insured, thus holding a Triple A credit rating from both Moody's and Standard & Poor's. Additional information on the City of Terrell's long-term debt can be found in Note 4 on pages 40 – 43 of this report.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

In the fiscal year 2006-07 budget, General Fund revenues and transfers in are budgeted to decrease by 6% from the 2005-06 budget year, with sales taxes making up about 46% of General Fund budgeted revenues and transfers in. Certified assessed valuations increased 7% over the preceding year. The tax base has increased by a strong annual average of 9.5% over the past five years. The City's budgets for all funds have benefited from an expanding local economy. However, the City's 2006-07 budget reflects a slower recovery in economic growth. The City of Terrell's favorable location continues to attract distribution firms and residential development. The City has imposed an impact fee for single-family housing developments. Sales tax receipts increased 4.7% for fiscal year 2005-06 and appears to continue to show signs of a marginal increase during the 2006-07 fiscal year. However, this revenue source is the most volatile and sensitive to changes in the local economy.

The budget for 2006-07 reflects the allocation of resources necessary to continue projects and operations at approximately the same level as last year.

REQUESTS FOR INFORMATION

The financial report is designed to provide our citizens, customers, investors and creditors with a general overview of the City's finances. If you have questions about this report or need any additional information, contact the Office of the City Secretary/Finance Director John Rounsavall at (972) 551-6600 or email jrounsavall@cityofterrell.org.

**BASIC
FINANCIAL STATEMENTS**

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CITY OF TERRELL, TEXAS
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2006

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
ASSETS			
Cash and investments	\$ 14,162,082	\$ 2,711,679	\$ 16,873,761
Receivables (net, where applicable, of allowances for uncollectibles)	1,608,367	1,319,040	2,927,407
Internal balances	(98,047)	98,047	-
Due from other governments	134,123	-	134,123
Special assessments	653,429	-	653,429
Investment in land	1,442,530	-	1,442,530
Funds in escrow	50,396	-	50,396
Inventory, at cost	6,208	140,771	146,979
Restricted cash and investments	-	514,078	514,078
Deferred charges	104,714	54,931	159,645
Capital assets:			
Land	665,035	885,019	1,550,054
Buildings and improvements	3,733,462	16,722,695	20,456,157
Improvements other than buildings	1,166,689	-	1,166,689
Machinery and equipment	4,704,739	26,440,459	31,145,198
Infrastructure	31,838,431	-	31,838,431
Construction in progress	1,922,394	4,009,006	5,931,400
Less accumulated depreciation	(23,413,267)	(18,837,005)	(42,250,272)
Total capital assets	<u>20,617,483</u>	<u>29,220,174</u>	<u>49,837,657</u>
Total assets	<u>38,681,285</u>	<u>34,058,720</u>	<u>72,740,005</u>
LIABILITIES			
Accounts payable	1,148,974	701,208	1,850,182
Accrued interest payable	108,492	13,785	122,277
Unearned revenue	12,268	-	12,268
Other accrued liabilities	7,491	-	7,491
Customer deposits	-	297,331	297,331
Long-term liabilities:			
Due within one year	2,699,673	151,795	2,851,468
Due in more than one year	20,602,274	1,977,182	22,579,456
Total liabilities	<u>24,579,172</u>	<u>3,141,301</u>	<u>27,720,473</u>
NET ASSETS			
Invested in capital assets, net of related debt	(1,647,319)	27,150,174	25,502,855
Restricted for:			
Economic development	2,212,918	-	2,212,918
Debt service	332,722	216,747	549,469
Capital projects	6,942,180	-	6,942,180
Other purposes	159,610	-	159,610
Unrestricted	<u>6,102,002</u>	<u>3,550,498</u>	<u>9,652,500</u>
Total net assets	<u>\$ 14,102,113</u>	<u>\$ 30,917,419</u>	<u>\$ 45,019,532</u>

The accompanying notes are an integral part of these financial statements.

CITY OF TERRELL, TEXAS

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED SEPTEMBER 30, 2006

Functions/Programs	Expenses	Program Revenue	
		Charges for Services	Operating Grants and Contributions
Primary government			
Governmental activities:			
General government	\$ 5,896,460	\$ 513,420	\$ 384,326
Public welfare	3,733,149	-	4,279,139
Public safety	6,103,070	275,430	-
Highways and streets	2,671,672	805,069	-
Sanitation	502,107	502,181	-
Culture and recreation	709,433	136,719	-
Interest on long-term debt	920,357	-	-
Total governmental activities	20,536,248	2,232,819	4,663,465
Business-type activities:			
Water and sewer	6,669,564	7,582,139	-
Airport	380,248	157,452	-
Total business-type activities	7,049,812	7,739,591	-
Total primary government	\$ 27,586,060	\$ 9,972,410	\$ 4,663,465

General revenues:

Taxes:

Property taxes, levied for general purposes

Property taxes, levied for debt service

Sales taxes

Franchise taxes

Other taxes

Unrestricted investment earnings

Miscellaneous

Total general revenues

Change in net assets

Net assets - beginning

Net assets - ending

The accompanying notes are an integral part of these financial statements.

Net (Expense) Revenue and Changes in Net Assets

Primary Government

<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
\$ (4,998,714)	\$ -	\$ (4,998,714)
545,990	-	545,990
(5,827,640)	-	(5,827,640)
(1,866,603)	-	(1,866,603)
74	-	74
(572,714)	-	(572,714)
(920,357)	-	(920,357)
<u>(13,639,964)</u>	<u>-</u>	<u>(13,639,964)</u>
-	912,575	912,575
-	<u>(222,796)</u>	<u>(222,796)</u>
<u>-</u>	<u>689,779</u>	<u>689,779</u>
-	689,779	689,779
<u>-</u>	<u>689,779</u>	<u>689,779</u>
3,931,037	-	3,931,037
1,562,177	-	1,562,177
7,002,351	-	7,002,351
1,726,828	-	1,726,828
235,195	-	235,195
278,335	66,492	344,827
284,098	379,325	663,423
<u>15,020,021</u>	<u>445,817</u>	<u>15,465,838</u>
1,380,057	1,135,596	2,515,653
<u>12,722,056</u>	<u>29,781,823</u>	<u>42,503,879</u>
<u>\$ 14,102,113</u>	<u>\$ 30,917,419</u>	<u>\$ 45,019,532</u>

CITY OF TERRELL, TEXAS

BALANCE SHEET

GOVERNMENTAL FUNDS

SEPTEMBER 30, 2006

	<u>General</u>	<u>Rent Supplement Section 8</u>	<u>Terrell Economic Development Corporation</u>
ASSETS			
Cash and investments	\$ 3,775,158	\$ 463,612	\$ 838,871
Taxes receivable, net	1,505,166	-	-
Due from other funds	672,003	-	13,158
Receivable from other governments	-	230	-
Special assessments	-	-	-
Investment in land	-	-	1,442,530
Funds in escrow	25,396	-	25,000
Inventories	<u>6,208</u>	<u>-</u>	<u>-</u>
 Total assets	 <u>\$ 5,983,931</u>	 <u>\$ 463,842</u>	 <u>\$ 2,319,559</u>
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	\$ 472,490	\$ 31,171	\$ 52,498
Due to other funds	36,916	-	54,143
Deferred revenue	<u>277,203</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>786,609</u>	<u>31,171</u>	<u>106,641</u>
Fund balances:			
Reserved for:			
Debt service	-	-	-
Grants/donations	-	-	-
Capital projects	-	-	1,442,530
Housing assistance	-	159,583	-
Unreserved	<u>5,197,322</u>	<u>273,088</u>	<u>770,388</u>
Total fund balances	<u>5,197,322</u>	<u>432,671</u>	<u>2,212,918</u>
 Total liabilities and fund balances	 <u>\$ 5,983,931</u>	 <u>\$ 463,842</u>	 <u>\$ 2,319,559</u>

The accompanying notes are an integral part of these financial statements.

Certificates of Obligation Tax and Revenue Series 2004	Other Governmental Funds	Total Governmental Funds
\$ 6,049,259	\$ 2,483,504	\$ 13,610,404
-	103,201	1,608,367
-	151,143	836,304
-	133,893	134,123
-	653,429	653,429
-	-	1,442,530
-	-	50,396
-	-	6,208
<u>\$ 6,049,259</u>	<u>\$ 3,525,170</u>	<u>\$ 18,341,761</u>
\$ 385,709	\$ 84,874	\$ 1,026,742
-	842,916	933,975
-	768,898	1,046,101
<u>385,709</u>	<u>1,696,688</u>	<u>3,006,818</u>
-	338,013	338,013
-	27	27
-	1,278,630	2,721,160
-	-	159,583
<u>5,663,550</u>	<u>211,812</u>	<u>12,116,160</u>
<u>5,663,550</u>	<u>1,828,482</u>	<u>15,334,943</u>
<u>\$ 6,049,259</u>	<u>\$ 3,525,170</u>	<u>\$ 18,341,761</u>

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CITY OF TERRELL, TEXAS

**RECONCILIATION OF THE GOVERNMENTAL FUNDS
BALANCE SHEET TO THE STATEMENT OF NET ASSETS**

SEPTEMBER 30, 2006

Total fund balance, governmental funds	\$ 15,334,943
Amounts reported for governmental activities in the Statement of Net Assets are different because:	
Capital assets used in governmental activities are not current financial resources and therefore are not reported in this fund financial statement, but are reported in the governmental activities of the Statement of Net Assets.	18,842,910
Certain other long-term assets are not available to pay current period expenditures and therefore are not reported in this fund financial statement, but are reported in the governmental activities of the Statement of Net Assets.	1,033,833
The assets and liabilities of certain Internal Service Funds are not included in the fund financial statement, but are included in the governmental activities of the Statement of Net Assets.	1,994,964
Some liabilities, (such as notes payable, long-term compensated absences, and bonds payable), are not due and payable in the current period and are not included in the fund financial statement, but are included in the governmental activities of the Statement of Net Assets.	(23,104,537)
Net assets of governmental activities in the Statement of Net Assets	\$ <u>14,102,113</u>

The accompanying notes are an integral part of these financial statements.

CITY OF TERRELL, TEXAS

**STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES**

GOVERNMENTAL FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	<u>General</u>	<u>Rent Supplement Section 8</u>	<u>Terrell Economic Development Corporation</u>
REVENUES			
Taxes and special assessments	\$ 12,668,329	\$ -	\$ -
Licenses and permits	200,055	-	-
Hotel/motel occupancy taxes	-	-	-
Fees and fines	286,448	-	-
Intergovernmental	866,425	3,037,031	-
Charges for services	595,856	-	1,000
Investment earnings	90,955	3,740	8,371
Street assessments	-	-	-
Miscellaneous	245,961	34,184	-
Total revenues	<u>14,954,029</u>	<u>3,074,955</u>	<u>9,371</u>
EXPENDITURES			
Current:			
General government	4,285,522	290,915	766,007
Public welfare	19,917	2,608,427	-
Public safety	5,823,381	-	-
Highways and streets	1,874,258	-	-
Sanitation	501,098	-	-
Culture and recreation	580,490	-	-
Principal	115,759	-	703,737
Interest and other charges	-	-	178,469
Capital outlay	1,290,549	-	161,303
Total expenditures	<u>14,490,974</u>	<u>2,899,342</u>	<u>1,809,516</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>463,055</u>	<u>175,613</u>	<u>(1,800,145)</u>
OTHER FINANCING SOURCES (USES)			
Proceeds from long-term debt	1,045,979	-	-
Gain on sale of capital assets	115,759	-	-
Transfers in	-	-	1,776,354
Transfers out	(1,736,037)	-	-
Total other financing sources and uses	<u>(574,299)</u>	<u>-</u>	<u>1,776,354</u>
NET CHANGE IN FUND BALANCES	<u>(111,244)</u>	<u>175,613</u>	<u>(23,791)</u>
FUND BALANCES, BEGINNING	<u>5,308,566</u>	<u>257,058</u>	<u>2,236,709</u>
FUND BALANCES, ENDING	<u>\$ 5,197,322</u>	<u>\$ 432,671</u>	<u>\$ 2,212,918</u>

The accompanying notes are an integral part of these financial statements.

Certificates of Obligation Tax and Revenue Series 2004	Other Governmental Funds	Total Governmental Funds
\$ -	\$ 1,555,247	\$ 14,223,576
-	-	200,055
-	197,432	197,432
-	-	286,448
-	1,088,985	4,992,441
-	778,045	1,374,901
151,586	16,605	271,257
-	44,724	44,724
-	1,668	281,813
<u>151,586</u>	<u>3,682,706</u>	<u>21,872,647</u>
-	314,588	5,657,032
-	977,651	3,605,995
-	-	5,823,381
-	-	1,874,258
-	-	501,098
-	-	580,490
-	915,908	1,735,404
63,224	615,556	857,249
<u>1,278,952</u>	<u>-</u>	<u>2,730,804</u>
<u>1,342,176</u>	<u>2,823,703</u>	<u>23,365,711</u>
(<u>1,190,590</u>)	<u>859,003</u>	(<u>1,493,064</u>)
1,570,000	-	2,615,979
-	-	115,759
-	-	1,776,354
-	(40,317)	(1,776,354)
<u>1,570,000</u>	(<u>40,317</u>)	<u>2,731,738</u>
379,410	818,686	1,238,674
<u>5,284,140</u>	<u>1,009,796</u>	<u>14,096,269</u>
\$ <u>5,663,550</u>	\$ <u>1,828,482</u>	\$ <u>15,334,943</u>

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CITY OF TERRELL, TEXAS

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES**

FOR THE YEAR ENDED SEPTEMBER 30, 2006

Net change in fund balances - total governmental funds: \$ 1,238,674

Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets as expenditures because such outlays use current financial resources. In contrast, the Statement of Activities reports only a portion of the outlay as expense. The outlay is allocated over the assets' estimated useful lives as depreciation expense for the period. This is the amount by which capital outlays exceeded depreciation in the current period. 1,044,291

Governmental funds do not present revenues that are not available to pay current obligations. In contrast, such revenues are reported in the Statement of Activities when earned. 25,641

Governmental funds report bond proceeds as current financial resources. In contrast, the Statement of Activities treats such issuance of debt as a liability. Governmental funds report repayment of bond principal as an expenditure, In contrast, the Statement of Activities treats such repayments as a reduction in long-term liabilities. This is the amount by which proceeds exceeded repayments. (876,620)

Some expenses reported in the Statement of Activities do not require the use of current financial resources and these are not reported as expenditures in governmental funds (270,434)

Internal Service Funds are used by management to charge the costs of certain activities, such as equipment maintenance and self-insurance, to individual funds. The net revenue (expense) of certain Internal Service Funds is reported with governmental activities. 218,505

Change in net assets of governmental activities \$ 1,380,057

The accompanying notes are an integral part of these financial statements.

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CITY OF TERRELL, TEXAS

**STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL**

GENERAL FUND

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Budgeted Amounts		Actual Amounts, Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Property taxes	\$ 3,900,201	\$ 3,900,201	\$ 3,901,387	\$ 1,186
Sales and miscellaneous taxes	7,997,790	8,752,224	8,766,942	14,718
Fees and fines	263,600	263,600	286,448	22,848
Licenses and permits	229,030	229,030	200,055	(28,975)
Intergovernmental	690,297	850,297	866,425	16,128
Charges for services	504,170	619,863	595,856	(24,007)
Investment earnings	40,000	40,000	90,955	50,955
Miscellaneous	222,969	240,321	245,961	5,640
Total revenues	<u>13,848,057</u>	<u>14,895,536</u>	<u>14,954,029</u>	<u>58,493</u>
EXPENDITURES				
Current:				
General government	6,066,140	6,215,698	4,285,522	1,930,176
Public welfare	-	-	19,917	(19,917)
Public safety	6,004,654	6,099,210	5,823,381	275,829
Highways and street	1,854,127	1,937,104	1,874,258	62,846
Sanitation	466,877	506,292	501,098	5,194
Culture and recreation	592,990	597,324	580,490	16,834
Debt service:				
Principal	-	-	115,759	(115,759)
Capital outlay	830,064	1,648,239	1,290,549	357,690
Total expenditures	<u>15,814,852</u>	<u>17,003,867</u>	<u>14,490,974</u>	<u>2,512,893</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(1,966,795)</u>	<u>(2,108,331)</u>	<u>463,055</u>	<u>2,571,386</u>
OTHER FINANCING SOURCES (USES)				
Proceeds from capital leases	-	-	1,045,979	1,045,979
Gain on sale of capital assets	-	-	115,759	115,759
Transfers out	-	-	(1,736,037)	(1,736,037)
Total other financing sources and uses	<u>-</u>	<u>-</u>	<u>(574,299)</u>	<u>(574,299)</u>
NET CHANGE IN FUND BALANCES	<u>(1,966,795)</u>	<u>(2,108,331)</u>	<u>(111,244)</u>	<u>(1,997,087)</u>
FUND BALANCES, BEGINNING	<u>5,308,566</u>	<u>5,308,566</u>	<u>5,308,566</u>	<u>-</u>
FUND BALANCES, ENDING	<u>\$ 3,341,771</u>	<u>\$ 3,200,235</u>	<u>\$ 5,197,322</u>	<u>\$ (1,997,087)</u>

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CITY OF TERRELL, TEXAS
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
SEPTEMBER 30, 2006

	Business-type Activities			Governmental
	Water and Sanitary Sewer	Airport	Total	Activities Internal Service Funds
ASSETS				
Current assets:				
Cash and investments	\$ 1,808,127	\$ 903,552	\$ 2,711,679	\$ 551,678
Cash and investments - restricted	514,078	-	514,078	-
Accounts receivable, net	1,319,040	-	1,319,040	-
Deferred charges	26,268	28,663	54,931	-
Due from other funds	143,427	10,269	153,696	-
Inventories at average cost	140,771	-	140,771	-
Total current assets	<u>3,951,711</u>	<u>942,484</u>	<u>4,894,195</u>	<u>551,678</u>
Non-current assets:				
Capital assets:				
Land	537,271	347,748	885,019	-
Buildings and improvements	4,846,314	11,876,381	16,722,695	-
Construction in progress	3,998,020	10,986	4,009,006	-
Machinery and equipment	26,303,260	137,199	26,440,459	3,675,733
Less accumulated depreciation	(15,353,230)	(3,483,775)	(18,837,005)	(1,901,160)
Total capital assets	<u>20,331,635</u>	<u>8,888,539</u>	<u>29,220,174</u>	<u>1,774,573</u>
Total non-current assets	<u>20,331,635</u>	<u>8,888,539</u>	<u>29,220,174</u>	<u>1,774,573</u>
Total assets	<u>\$ 24,283,346</u>	<u>\$ 9,831,023</u>	<u>\$ 34,114,369</u>	<u>\$ 2,326,251</u>
LIABILITIES				
Current liabilities:				
Accounts payable	\$ 589,454	\$ 111,754	\$ 701,208	\$ 122,232
Accrued interest payable	6,010	7,775	13,785	-
Due to other funds	55,649	-	55,649	376
Other accrued expenses	-	-	-	7,491
Compensated absences	11,795	-	11,795	9,067
Bonds, notes and loans payable	85,000	55,000	140,000	70,232
Total current liabilities	<u>747,908</u>	<u>174,529</u>	<u>922,437</u>	<u>209,398</u>
Non-current liabilities:				
Compensated absences	47,182	-	47,182	-
Customer deposits	297,331	-	297,331	-
Bonds, notes and loans payable	600,000	1,330,000	1,930,000	121,889
Total non-current liabilities	<u>944,513</u>	<u>1,330,000</u>	<u>2,274,513</u>	<u>121,889</u>
Total liabilities	<u>1,692,421</u>	<u>1,504,529</u>	<u>3,196,950</u>	<u>331,287</u>
NET ASSETS				
Invested in capital assets, net of related debt	19,646,635	7,503,539	27,150,174	1,582,452
Restricted for debt service	216,747	-	216,747	-
Unrestricted	2,727,543	822,955	3,550,498	412,512
Total net assets	<u>\$ 22,590,925</u>	<u>\$ 8,326,494</u>	<u>\$ 30,917,419</u>	<u>\$ 1,994,964</u>

The accompanying notes are an integral part of these financial statements.

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CITY OF TERRELL, TEXAS

**STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET ASSETS**

PROPRIETARY FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Business-type Activities			Governmental Activities Internal Service Funds
	Water and Sanitary Sewer	Airport	Total	
OPERATING REVENUES				
Charges for services	\$ 7,582,139	\$ -	\$ 7,582,139	\$ 1,310,000
Rental Income		157,452	157,452	-
Contributions	-	-	-	1,165,323
Miscellaneous	<u>376,128</u>	<u>3,197</u>	<u>379,325</u>	<u>172,567</u>
Total operating revenues	<u>7,958,267</u>	<u>160,649</u>	<u>8,118,916</u>	<u>2,647,890</u>
OPERATING EXPENSES				
Cost of sales and services	5,415,576	75,475	5,491,051	183,785
Administration	571,521	-	571,521	136,672
Utilities	-	-	-	568,913
Repairs and maintenance	-	-	-	68,034
Other supplies and expenses	-	-	-	284,560
Insurance claims and expenses	-	-	-	945,104
Depreciation	<u>651,969</u>	<u>242,983</u>	<u>894,952</u>	<u>296,361</u>
Total operating expenses	<u>6,639,066</u>	<u>318,458</u>	<u>6,957,524</u>	<u>2,483,429</u>
OPERATING INCOME (LOSS)	<u>1,319,201</u>	<u>(157,809)</u>	<u>1,161,392</u>	<u>164,461</u>
NON-OPERATING REVENUES (EXPENSES)				
Interest and investment revenues	48,065	18,427	66,492	7,078
Interest expense	<u>(30,498)</u>	<u>(61,790)</u>	<u>(92,288)</u>	<u>(5,255)</u>
Total non-operating revenues (expenses)	<u>17,567</u>	<u>(43,363)</u>	<u>(25,796)</u>	<u>1,823</u>
CHANGE IN NET ASSETS	1,336,768	(201,172)	1,135,596	166,284
TOTAL NET ASSETS, BEGINNING	<u>21,254,157</u>	<u>8,527,666</u>	<u>29,781,823</u>	<u>1,828,680</u>
TOTAL NET ASSETS, ENDING	<u>\$ 22,590,925</u>	<u>\$ 8,326,494</u>	<u>\$ 30,917,419</u>	<u>\$ 1,994,964</u>

The accompanying notes are an integral part of these financial statements.

CITY OF TERRELL, TEXAS

STATEMENT OF CASH FLOWS

PROPRIETARY FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Business-type Activities			Governmental Activities Internal Service Funds
	Water and Sanitary Sewer	Airport	Total	
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers and users	\$ 8,004,216	\$ 160,649	\$ 8,164,865	\$ 2,647,890
Cash paid for services and insurance claims	-	-	-	(1,474,141)
Cash paid to suppliers for goods and services	(3,319,767)	(74,404)	(3,394,171)	(487,629)
Cash paid to employees for services	(2,272,063)	-	(2,272,063)	(183,848)
Net cash provided by operating activities	<u>2,412,386</u>	<u>86,245</u>	<u>2,498,631</u>	<u>502,272</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Cash received from other funds	363	-	363	376
Cash paid to other funds	(27,616)	(5,627)	(33,243)	(363)
Net cash provided (used) for noncapital financing activities	<u>(27,253)</u>	<u>(5,627)</u>	<u>(32,880)</u>	<u>13</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Acquisition of capital assets	(1,967,268)	(14,171)	(1,981,439)	(285,099)
Principal paid on long-term debt	(85,000)	(55,000)	(140,000)	(74,602)
Interest and fiscal charges paid on debt	(28,637)	(58,606)	(87,243)	(5,255)
Net cash used for capital and related financing activities	<u>(2,080,905)</u>	<u>(127,777)</u>	<u>(2,208,682)</u>	<u>(364,956)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Investment earnings	<u>48,065</u>	<u>18,427</u>	<u>66,492</u>	<u>7,078</u>
Net cash provided by investing activities	<u>48,065</u>	<u>18,427</u>	<u>66,492</u>	<u>7,078</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	352,293	(28,732)	323,561	144,407
CASH AND CASH EQUIVALENTS, BEGINNING	<u>1,969,912</u>	<u>932,284</u>	<u>2,902,196</u>	<u>407,271</u>
CASH AND CASH EQUIVALENTS, ENDING	<u>\$ 2,322,205</u>	<u>\$ 903,552</u>	<u>\$ 3,225,757</u>	<u>\$ 551,678</u>

(continued)

CITY OF TERRELL, TEXAS

STATEMENT OF CASH FLOWS

PROPRIETARY FUNDS

(Continued)

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Business-type			Governmental Activities Internal Service Funds
	Water and Sanitary Sewer	Airport	Total	
Reconciliation of operating income (loss) to net cash provided by operating activities:				
Operating income (loss)	\$ 1,319,201	\$ (157,809)	\$ 1,161,392	\$ 164,461
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation	651,969	242,983	894,952	296,361
Changes in assets and liabilities:				
Decrease (increase) in assets:				
Customer receivable	29,210	-	29,210	-
Inventories	(13,049)	-	(13,049)	-
Increase (decrease) in liabilities:				
Accounts payable	407,771	109,225	516,996	43,057
Accrued liabilities	-	(108,154)	(108,154)	(1,544)
Compensated absences	545	-	545	(63)
Customer deposits	16,739	-	16,739	-
Net cash provided by operating activities	<u>\$ 2,412,386</u>	<u>\$ 86,245</u>	<u>\$ 2,498,631</u>	<u>\$ 502,272</u>

The notes to the financial statements are an integral part of this statement.

CITY OF TERRELL, TEXAS

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Terrell (the "City") was incorporated on September 6, 1875, under an act of the 14th Legislature of the State of Texas. The City operates under a Council-Manager form of government and provides the following services: public safety (police and fire); highways and streets; sanitation; culture-recreation; public improvements; planning and zoning; and general administrative services.

The accounting policies of the City of Terrell conform to generally accepted accounting principles as applicable to local governments. The following is a summary of the more significant accounting policies.

A. Reporting Entity

As required by generally accepted accounting principles, these financial statements have been prepared based on considerations regarding the potential for inclusion of other entities, organizations, or functions as part of the City's financial reporting entity. Based on these considerations, the Terrell Economic Development Corporation has been included in the City's reporting entity as blended component unit; although legally separate entity is in substance a part of the City's operations.

The Terrell Economic Development Corporation ("TEDC") was incorporated in 1990 under the provisions of the Development Corporation Act of 1979, as amended. TEDC operates under a five-member Board of Directors appointed by the City Council. The purpose of TEDC is to promote and develop commercial, industrial, and manufacturing enterprises to create and enhance local job opportunities. The City Council maintains organizational control over TEDC in addition to significant managerial control over the assets and operations. TEDC has been incorporated into these financial statements as a major governmental fund. Essential disclosures are included in separately issued financial statements of the TEDC. These statements may be obtained at the City's administrative office.

The Terrell Development Corporation (the "Corporation") was created in 1979 for the special purpose of promoting and developing commercial, industrial and manufacturing enterprise and encouraging employment in the City. The members of the Board of the Corporation are appointed by the City Council. The Corporation is authorized to issue industrial development revenue bonds after approval of the City Council. During 1997, the Corporation issued \$7,600,000 of development revenue bonds. The bonds do not constitute indebtedness of the City and are secured solely by the revenues received from the commercial organization on whose behalf they were issued. The City assumes no responsibility for the operating expenses of the Corporation as they are financed by fees charged to the commercial organization. The Corporation has been excluded from the City's financial statements.

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the City.

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

The City reports the following major governmental funds:

The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The Section 8 Rent Supplement Fund is a Special Revenue Fund used to account for federal funds received under contract from the Department of Housing and Urban Development for housing rental assistance.

The Terrell Economic Development Fund is a component unit of the City and accounts for ½ cent sales tax revenues used to promote and develop commercial, industrial and manufacturing enterprises to create and enhance job opportunities.

The C. O. Tax and Revenue Series 2004 Fund is a Capital Projects Fund used to account for construction projects funded by the Series 2004 Bond issuance.

The City reports the following major proprietary funds:

The Water and Sanitary Sewer Fund is used to account for sale of water and wastewater treatment by the City to businesses and residential customers and to surrounding communities.

The Airport Fund is used to account for operations of the Terrell Municipal Airport.

Additionally, the City reports the following fund types:

Internal Service Funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the City on a cost-reimbursement basis. The City reports the following Internal Service Funds:

Self-insurance Fund – to account for the City's self-insurance programs.

Equipment Replacement Fund – to track fleet maintenance, repair and replacement.

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Private-sector standards of accounting and financial reporting issued prior to December 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Government Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and Enterprise Funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to the general rule are charges between the City's water utilities function and various other functions. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's Enterprise Funds and of the Internal Service Funds are charges to customers for sales and services. The City also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for Enterprise Funds and Internal Service Funds include the cost of sales and services, administrative expense, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, Liabilities, and Net Assets or Equity

Equity in Pooled Cash and Investments

The City reclassifies certain of its cash and investments into equity in pooled cash and investments. Each fund participates on a daily transaction basis and income for all assets included in pooled cash and investments is allocated to individual funds based on their respective balance in equity in pooled cash and investments.

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

Equity in Pooled Cash and Investments (Continued)

Additionally, deposits and investments continue to be held separately by several of the City's funds. Income on these assets is recorded in the respective fund holding the deposits and investments.

All assets in equity in pooled cash and investments and demand deposits on hand have been considered as cash equivalents for purposes of the statement of cash flows.

Investments

State statutes authorize the City to invest in obligations of the U. S. Treasury, commercial paper, corporate bonds, and repurchase agreements. Investments are stated at fair value.

Investment in Land

The Terrell Economic Development Corporation invests in land to sell to prospective businesses to enhance economic development. Investment in land is stated at cost.

Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

All receivables are shown net of an allowance for uncollectible. The City provides an allowance for doubtful accounts based upon the anticipated collectibility of each specific account as determined by experience.

Property taxes are levied October 1 on the assessed value of property at January 1 and are due by January 31 of the following year. The total assessed value of property was \$830,551,292 and the tax rates were \$.4645 per \$100 valuation for maintenance and operations and \$.1855 per \$100 valuation for debt service. Unpaid taxes attach as an enforceable lien on property as of January 31. Revenue from taxes assessed is recorded as deferred revenue on October 1. The deferred revenue from taxes is then recognized as revenue during the year as the taxes are actually received.

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

Inventories and Prepaid Items

Inventories of materials and supplies are accounted for using the consumption method. Under the consumption method, inventories are recorded as expenditures when they are used with significant amounts on hand reported on the balance sheet at average cost. In governmental funds, reported inventories do not represent available spendable resources and are, therefore, equally offset by a fund balance reservation.

Restricted Assets

Certain proceeds of the City's Enterprise Fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants. The Water and Sanitary Sewer Fund Debt Service Fund account is used to segregate resources accumulated for debt service payments over the life of the bonds.

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 (amount not rounded) and an estimated life in excess of three years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets are not capitalized.

Property, plant and equipment of the primary government, as well as the component units, is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	45
Building improvements	10 - 20
Improvements other than buildings	20 - 45
Public domain infrastructure	20 - 40
Vehicles	12
Heavy equipment	10 - 15
Office equipment	7
Computer equipment	5 - 7

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

Construction in Progress

Expenditures on incomplete capital projects have been capitalized as construction in progress. The assets resulting from these projects will be transferred from the construction in progress accounts to the appropriate asset account as the projects are completed. Interest incurred, when material, during the construction phase of business-type activities is included as a part of the capitalized value of the constructed asset. During the fiscal year ended September 30, 2006, there was no interest capitalized.

Compensated Absences

The City's vacation pay policy provides that vacation pay accrues at various rates based on length of service up to the maximum of 21 days per year. Generally, sick leave is not paid upon termination except for firemen and policemen. Firemen and policemen accumulate unused sick leave up to a maximum of 90 days. All other employees are paid only upon illness while in the employ of the City.

As of September 30, 2006, the liability for accrued vacation leave and accrued sick leave is \$1,096,122. The amount applicable to the Enterprise Funds (\$58,977) has been recorded in those funds, and the amount applicable to other funds (\$1,037,145) has been recorded in the Statement of Net Assets for governmental activities.

Long-term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method, which approximates the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

(continued)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

Fund Equity

Reserves of fund balance or retained earnings are used to indicate that a portion of fund equity is not available for expenditure or is legally segregated for a specific future use. Designated fund balances represent tentative plans for future use of financial resources.

Net Assets

Net assets represents the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of the City's capital assets, net of accumulated depreciation, reduced by any outstanding debt used for the acquisition or construction of those assets. Net assets reported as restricted are those amounts which have limitations imposed on their use either through legislation adopted by the City or through external restrictions imposed by creditors, grantors or other laws and regulations.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Encumbrances

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed in governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balances since they do not constitute expenditures or liabilities. There were no encumbrances outstanding at September 30, 2006.

In accordance with the budgetary policies of the City, encumbrance accounting is also employed by proprietary fund types for management control purposes. Encumbrances outstanding at year-end are not reported as reservations of retained earnings nor have they been included as expenses or liabilities of proprietary fund types.

2. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS
(Continued)

B. Explanation of Certain Differences Between the Governmental Fund Statement of Revenue, Expenditures and Changes in Fund Balances and the Government-wide Statement of Activities (Continued)

Another element of that reconciliation states, "Certain receivables will be collected next year but are not available soon enough to pay for the current period's expenditures and, therefore, are reported as deferred revenues in the funds." The details of this \$25,641 difference are as follows:

Deferred property tax revenues	\$ 36,580
Deferred special assessments	(10,939)
Net adjustment to increase <i>fund balance - total governmental funds</i> to arrive at <i>net assets - governmental activities</i>	\$ <u>25,641</u>

Another element of that reconciliation states, "The issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities." The details of this \$876,620 difference are as follows:

Issuance of certificates of obligation	\$ 1,570,000
Notes payable acquired	1,045,979
Principal repayments	(1,739,359)
Net adjustment to reduce <i>fund balance - total governmental funds</i> to arrive at <i>net assets - governmental activities</i>	\$ <u>876,620</u>

3. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Information

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to August 1, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following October 1. The operating budget includes proposed expenditures and the means of financing them.
2. Prior to October 1, the budget is legally enacted through passage of an ordinance.
3. The City Council approves, by ordinance, budget appropriations on a departmental basis. The City Manager is authorized to transfer budget amounts within any department; however, any revisions that alter the total departmental appropriation must be approved by the City Council. Therefore, the level of budgetary responsibility is by total appropriations for each department.
4. A formal budget is adopted for the General Fund on a basis consistent with generally accepted accounting principles.
5. Several budget amendments were made during the year.
6. Appropriations lapse at year-end.

B. Expenditures Over Appropriations

Expenditures exceeded appropriations in the Public Welfare function by \$19,917 and the Debt Service Principal function by \$115,759 in the General Fund.

C. Deficit Fund Balance/Net Assets

The Certificates of Obligation Tax and Revenue Series 2002 Fund and the Self-Insurance Internal Service Fund had deficit equity balances of \$74,214 and \$117,360, respectively, as of September 30, 2006. The deficit equity balances will be covered by future transfers from the General Fund.

4. DETAILED NOTES ON ALL FUNDS

Deposits and Investments

Custodial Credit Risk. In the case of deposits, this is the risk that in the event of a bank failure, the City's deposits may not be returned to it. State statutes require that all deposits in financial institutions be fully collateralized by U. S. Government obligations or its agencies and instrumentalities or direct obligations of Texas or its agencies and instrumentalities that have a fair value of not less than the principal amount of deposits. As of September 30, 2006, \$15,807,497 of the City's \$16,007,497 deposit balance was collateralized with securities held by the pledging financial institution. The remaining balance, \$200,000 was covered by FDIC insurance.

(continued)

4. **DETAILED NOTES ON ALL FUNDS (Continued)**

Deposits and Investments (Continued)

The City Council has adopted a written investment policy regarding the investments of its funds as defined by the Public Funds Investment Act of 1995 (Chapter 2256, Texas Government Code). The investments of the City are in compliance with the Council's investment policies. All significant legal and contractual provisions for investments were complied with during the year.

Receivables

Receivables as of year-end for the City's individual major funds and nonmajor and Internal Service Funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Nonmajor and Other</u>	<u>Water Utilities</u>	<u>Total</u>
Receivables:				
Taxes	\$ 1,554,083	\$ 121,413	\$ -	\$ 1,675,496
Special assessment	-	809,563	-	809,563
Accounts	-	-	1,364,654	1,364,654
Gross receivables	1,554,083	930,976	1,364,654	3,849,713
Less: allowance for uncollectibles	<u>48,917</u>	<u>174,346</u>	<u>45,614</u>	<u>268,877</u>
Net total receivables	<u>\$ 1,505,166</u>	<u>\$ 756,630</u>	<u>\$ 1,319,040</u>	<u>\$ 3,580,836</u>

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of deferred revenue and unearned revenue reported in the governmental funds were as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Street improvement assessments	\$ 653,429	\$ -
Property taxes	380,404	-
Grants	<u>-</u>	<u>12,268</u>
Total	<u>\$ 1,033,833</u>	<u>\$ 12,268</u>

(continued)

4. DETAILED NOTES ON ALL FUNDS (Continued)

Capital Assets

Capital asset activity for the year ended September 30, 2006, was as follows:

Primary Government

	Beginning Balance	Increases	Reclassification/ Decreases	Ending Balance
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 137,200	\$ 643,594	\$ 115,759	\$ 665,035
Construction in progress	<u>594,855</u>	<u>1,327,539</u>	<u>-</u>	<u>1,922,394</u>
Total assets not being depreciated	<u>732,055</u>	<u>1,971,133</u>	<u>115,759</u>	<u>2,587,429</u>
Capital assets, being depreciated:				
Buildings	3,733,462	-	-	3,733,462
Improvements, other than buildings	1,166,689	-	-	1,166,689
Machinery and equipment	4,500,696	514,932	310,889	4,704,739
Infrastructure	<u>31,832,736</u>	<u>5,695</u>	<u>-</u>	<u>31,838,431</u>
Total capital assets being depreciated	<u>41,233,583</u>	<u>520,627</u>	<u>310,889</u>	<u>41,443,321</u>
Less accumulated depreciation:				
Buildings	1,664,379	82,579	-	1,746,958
Improvements, other than buildings	656,225	46,816	-	703,041
Machinery and equipment	2,165,186	400,398	242,006	2,323,578
Infrastructure	<u>17,874,556</u>	<u>765,134</u>	<u>-</u>	<u>18,639,690</u>
Total accumulated depreciation	<u>22,360,346</u>	<u>1,294,927</u>	<u>242,006</u>	<u>23,413,267</u>
Total capital assets being depreciated, net	<u>18,873,237</u>	<u>(774,300)</u>	<u>68,883</u>	<u>18,030,054</u>
Governmental activities capital assets, net	<u>\$ 19,605,292</u>	<u>\$ 1,196,833</u>	<u>\$ 184,642</u>	<u>\$ 20,617,483</u>
Business-type Activities				
Capital assets, not being depreciated:				
Land	\$ 885,019	\$ -	\$ -	\$ 885,019
Construction in progress	<u>2,100,243</u>	<u>1,908,763</u>	<u>-</u>	<u>4,009,006</u>
Total assets not being depreciated	<u>2,985,262</u>	<u>1,908,763</u>	<u>-</u>	<u>4,894,025</u>
Capital assets, being depreciated:				
Buildings and improvements	18,892,338	1,259	2,170,902	16,722,695
Machinery and equipment	<u>24,204,242</u>	<u>82,850</u>	<u>(2,153,367)</u>	<u>26,440,459</u>
Total capital assets being depreciated	<u>43,096,580</u>	<u>84,109</u>	<u>17,535</u>	<u>43,163,154</u>
Less accumulated depreciation:				
Buildings and improvements	6,952,393	537,878	(1,681,371)	9,171,642
Machinery and equipment	<u>10,995,762</u>	<u>357,074</u>	<u>1,687,473</u>	<u>9,665,363</u>
Total accumulated depreciation	<u>17,948,155</u>	<u>894,952</u>	<u>6,102</u>	<u>18,837,005</u>
Total capital assets being depreciated, net	<u>25,148,425</u>	<u>(810,843)</u>	<u>11,433</u>	<u>24,326,149</u>
Business-type activities capital assets, net	<u>\$ 28,133,687</u>	<u>\$ 1,097,920</u>	<u>\$ 11,433</u>	<u>\$ 29,220,174</u>

(continued)

4. **DETAILED NOTES ON ALL FUNDS (Continued)**

Capital Assets (Continued)

Depreciation was charged to functions/programs of the primary government as follows:

Governmental activities:		
General government		\$ 75,892
Public safety		68,901
Highways and streets		751,921
Culture and recreation		101,852
Capital assets held by the City's internal service funds are charged to the various functions based on their usage		<u>296,361</u>
Total depreciation expense - governmental activities		<u>\$ 1,294,927</u>
Business-type activities:		
Water and sanitary sewer		\$ 651,969
Airport		<u>242,983</u>
Total depreciation expense - business-type activities		<u>\$ 894,952</u>

Construction Commitments

The City has active construction projects as of September 30, 2006. The projects include street construction and expansion. At year-end, the City's commitments with contractors are as follows:

<u>Project</u>	<u>Contract Amounts</u>	<u>Spent to Date</u>	<u>Estimated Remaining Commitment</u>
Various street and utilities improvements	\$ <u>14,165,022</u>	\$ <u>5,930,401</u>	\$ <u>8,234,621</u>

(continued)

4. **DETAILED NOTES ON ALL FUNDS (Continued)**

Interfund Receivables and Payables and Transfers

The composition of interfund balances as of September 30, 2006, is as follows:

Due to/from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General fund	Water and Sanitary Sewer	\$ 45,380
	Nonmajor governmental	626,247
	Internal service	376
Economic development corporation	Nonmajor governmental	13,158
Water and Sanitary Sewer	General	36,916
	Nonmajor governmental	106,511
Nonmajor governmental	Economic development corporation	54,143
	Nonmajor governmental	97,000
Airport	Water and Sanitary Sewer	<u>10,269</u>
		<u>\$ 990,000</u>

These balances resulted from the time lag between the dates that 1) interfund goods and services are provided on reimbursable expenditures, and 2) transactions are recorded in the accounting system, and 3) payments between funds are made.

Interfund transfers:

<u>Transfers out</u>	<u>Transfers in</u> Terrell Economic Development Corporation
General	\$ 1,736,037
Nonmajor governmental	<u>40,317</u>
	<u>\$ 1,776,354</u>

Transfers are used to move revenues from the fund required by statute or budget to collect them to the fund expending them.

(continued)

4. **DETAILED NOTES ON ALL FUNDS (Continued)**

Long-term Debt

Bonded Debt

Bonded debt of the City as of September 30, 2006, is comprised of the following individual issues:

	<u>Interest Rates</u>	<u>Date Issued</u>	<u>Maturity Date</u>	<u>Amount of Original Issue</u>	<u>Amount Outstanding</u>
Water and Sewer Revenue Bonds:					
Series 1973	4.10 - 4.15%	01/10/1973	01/10/2013	\$ 1,000,000	\$ 650,000
Series 1970	3.65 - 3.70%	07/10/1970	01/10/2007	730,000	<u>35,000</u>
					<u>685,000</u>
Certificates of Obligation:					
Series 1999	3.75 - 4.75%	03/02/1999	02/15/2016	4,500,000	3,765,000
Series 2002	3.60 - 4.90%	07/23/2002	02/15/2022	4,500,000	3,415,000
Series 2003	4.00 - 4.70%	03/21/2003	02/15/2023	1,500,000	1,385,000
Series 2004	3.00 - 4.50%	09/15/2004	02/15/2024	5,500,000	4,935,000
Series 2006	4.00 - 4.375%	08/15/2006	02/15/2026	1,570,000	<u>1,570,000</u>
					<u>15,070,000</u>
General Obligation Bonds:					
Series 2004	2.00 - 3.375%	03/01/2005	02/15/2014	3,835,000	<u>3,095,000</u>
					<u>3,095,000</u>
					<u>\$ 18,850,000</u>

Annual debt service requirements to maturity for bonded debt are as follows:

Year Ending September 30,	Certificates of Obligation Tax Supported		Revenue Bonds		General Obligation Bonds	
	Principal	Interest	Principal	Interest	Principal	Interest
2007	\$ 1,040,000	\$ 632,829	\$ 85,000	\$ 26,314	\$ 385,000	\$ 77,044
2008	670,000	583,054	100,000	22,600	385,000	69,344
2009	700,000	554,273	100,000	18,500	370,000	61,331
2010	735,000	524,878	100,000	14,400	380,000	52,419
2011	765,000	495,010	100,000	10,300	380,000	42,306
2012-2016	4,405,000	1,971,233	200,000	8,275	1,195,000	56,234
2017-2021	4,725,000	947,276	-	-	-	-
2022-2026	<u>2,030,000</u>	<u>143,905</u>	-	-	-	-
Total	<u>\$ 15,070,000</u>	<u>\$ 5,852,458</u>	<u>\$ 685,000</u>	<u>\$ 100,389</u>	<u>\$ 3,095,000</u>	<u>\$ 358,678</u>

(continued)

4. **DETAILED NOTES ON ALL FUNDS (Continued)**

Long-term Debt (Continued)

Notes Payable

As of September 30, 2006, the City's notes payable consisted of the following:

The Terrell Economic Development Corporation, a component unit of the City of Terrell, had an outstanding balance of \$594,870 of its \$3,559,797 construction note from a local bank for funding of capital improvements to Airport Road. The note is secured by sales tax revenues of the Corporation and will service monthly over a five-year period at 3.65% interest.

The Terrell Economic Development Corporation (TEDC) entered into a note payable agreement with a local bank on September 18, 2005. As of September 30, 2006, the balance was \$3,161,796. The loan is secured by sales tax revenues of the Corporation and will service monthly over a 15-year period at 4.49% interest.

\$102,060 equipment note to a bank for the purchase of a 2004 jet truck. The note is due in four annual payments of \$27,118, including interest at 2.5%, with the final payment of unpaid balance due November 30, 2008. The note is secured by the 2004 jet truck.

\$19,196 equipment note to a bank for the purchase of a 2004 New Holland tractor. The note is due in two annual payments of \$9,883, including interest at 2%, with the final payment of unpaid balance due November 30, 2006. The note is secured by the 2004 New Holland tractor.

\$122,982 equipment note to a bank for the purchase of a 2004 Elgin street sweeper. The note is due in four annual payments of \$32,677, including interest at 2.5%, with the final payment of unpaid balance due November 30, 2008. The note is secured by the 2004 Elgin street sweeper.

\$22,485 equipment note to a bank for the purchase of a vacuum trailer. The note is due in two annual payments of \$11,646, including interest at 2%, with the final payment of unpaid balance due November 30, 2006. The note is secured by the vacuum trailer.

\$610,000 lease purchase agreement with Wells Fargo for the purchase of a records management system for police department. The agreement calls for five annual payments of \$133,349, including interest at 3.48%, with the final payment of the unpaid balance due October 14, 2009.

(continued)

4. DETAILED NOTES ON ALL FUNDS (Continued)

Long-term Debt (Continued)

Notes Payable (Continued)

\$345,979 equipment note to a bank for the purchase of a fire pumper. The note is due in five annual payments of \$75,225, including interest at 4.0%, with the final payment of unpaid balance due October 15, 2010. The note is secured by the fire pumper.

\$700,000 real estate note to a bank for the purchase of property at 1220 Brin. The note is due in five annual payments of \$159,855, including interest at 4.59%, with the final payment of unpaid balance due October 15, 2010. The note is secured by the real estate.

Future maturities and amounts paid under the notes after September 30, 2006, are as follows:

<u>Year Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 1,122,244	\$ 217,650
2008	640,095	182,399
2009	567,859	158,308
2010	554,240	135,656
2011	432,970	112,070
2012-2016	1,256,475	350,856
2017-2021	<u>910,919</u>	<u>63,605</u>
Total	<u>\$ 5,484,802</u>	<u>\$ 1,220,544</u>

Changes in Long-term Liabilities

Long-term liability activity for the year ended September 30, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Governmental activities					
Compensated absences	\$ 828,582	\$ 208,563	\$ -	\$ 1,037,145	\$ 207,429
Notes payable	5,362,784	1,045,979	923,961	5,484,802	1,122,244
Certificates of obligation	12,630,000	1,570,000	515,000	13,685,000	985,000
General obligation bonds	<u>3,470,000</u>	<u>-</u>	<u>375,000</u>	<u>3,095,000</u>	<u>385,000</u>
Governmental activities long-term liabilities	<u>\$ 22,291,366</u>	<u>\$ 2,824,542</u>	<u>\$ 1,813,961</u>	<u>\$ 23,301,947</u>	<u>\$ 2,699,673</u>
Business-type activities					
Compensated absences	\$ 58,432	\$ 545	\$ -	\$ 58,977	\$ 11,795
Certificates of obligation	1,440,000	-	55,000	1,385,000	55,000
Revenue bonds	<u>770,000</u>	<u>-</u>	<u>85,000</u>	<u>685,000</u>	<u>85,000</u>
Business-type activities long-term liabilities	<u>\$ 2,268,432</u>	<u>\$ 545</u>	<u>\$ 140,000</u>	<u>\$ 2,128,977</u>	<u>\$ 151,795</u>

(continued)

4. DETAILED NOTES ON ALL FUNDS (Continued)

Long-term Debt (Continued)

Bond Covenants

Bond covenants require the following disclosures:

	<u>Interest and Sinking</u>	<u>Reserve</u>
First Lien Bonds:		
Required ultimate balance	\$ -	\$ 212,240
Required present balance, end of year	30,492	212,240
Actual present balance, end of year	93,498	238,017

Contingent Liabilities

The City is defendant in various lawsuits. Although the outcome of the lawsuits is not presently determinable, in the opinion of the City Attorney, the resolution of these matters will not have a material adverse effect on the financial condition of the City.

The City participates in a number of federal and state assisted grant programs. These programs are subject to program compliance audits by the grantors or their representatives. The audits of these programs for the year ended September 30, 2006, have not yet been conducted. Accordingly, the City's compliance with applicable grant requirements will be established at some future date. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time although the City expects such amounts, if any, to be immaterial.

On November 28, 1997, the City was issued an Administrative Order from Region VI of the U. S. Environmental Protection Agency ("EPA") for apparent violations of the City's National Pollution Discharge Elimination System Permit ("NPDES" Permit) for exceeding the allowable amount of silver, which could be discharged from the City's wastewater treatment plant. Failure of the City to comply with the Order could result in substantial penalties being assessed against the City.

Self-insurance Plan

The City has established a self-insurance plan for health care benefits that pays 100% of employee claims limited to \$15,000 per employee and \$650,000 in aggregate. The City has insured claims in excess of plan limits. Accrued claims payable include provisions for claims reported and claims incurred but not reported. The provision for reported claims is determined by estimating the amount which will ultimately be paid each claimant. The provision for claims incurred but not yet reported is estimated based on the City's experience. Claims liabilities are reevaluated periodically to take into consideration settlement of claims, new claims, and other factors. As of September 30, 2006 and 2005, the estimated value of these liabilities was \$116,984 and \$77,108, respectively.

(continued)

4. DETAILED NOTES ON ALL FUNDS (Continued)

Retirement Commitments

The City provides pension benefits for all of its fulltime employees through a nontraditional, joint contributory, hybrid defined benefit plan in the statewide Texas Municipal Retirement System (TMRS), one of over 811 administered by TMRS, an agent multiple-employer public employee retirement system.

Benefits depend upon the sum of the employee's contributions to the plan, with interest, and the City-financed monetary credits, with interest. At the date the plan began, the City granted monetary credits for service rendered before the plan began of a theoretical amount equal to two times what would have been contributed by the employee, with interest, prior to establishment of the plan. Monetary credits for service since the plan began, are a percent (100%, 150%, or 200%) of the employee's accumulated contributions. In addition, the City can grant, as often as annually, another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and City matching percent had always been in existence and if the employee's salary had always been the average of his salary in the last three years that are one year before the effective date. At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions with interest and the employer-financed monetary credits with interest were used to purchase an annuity.

Members can retire at ages 60 and above with 5 or more years of service or with 20 years of service regardless of age. The plan provisions are adopted by the governing body of the City, within the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes.

The contribution rate for the employees is 7% and the City matching percent is currently 2 to 1, both as adopted by the governing body of the City. Under the state law governing TMRS, the actuary annually determines the City contribution rate. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to the City matching percent, which are the obligation of the City as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of the City to each employee at the time his/her retirement becomes effective. The prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the remainder of the plan's 25-year amortization period. When the City periodically adopts updated service credits and increases in annuities in effect, the increased unfunded actuarial liability is to be amortized over a new 25-year period. The unit credit actuarial cost method is used for determining the City contribution rate. Both the employees and the City make contributions monthly. Since the City needs to know its contribution rate in advance to budget for it, there is a one-year delay between the actuarial valuation that is the basis for the rate and the calendar year when the rate goes into effect, (i.e., December 31, 2005, valuation is effective for rates beginning January 2007).

(continued)

4. **DETAILED NOTES ON ALL FUNDS (Continued)**

Retirement Commitments (Continued)

Schedule of Actuarial Liabilities and Funding Progress

Actual Valuation Date	12/031/03	12/031/04	12/031/05
Actuarial value of assets	\$ 12,871,291	\$ 11,777,623	\$ 12,338,896
Actuarial accrued liability	17,274,745	15,956,385	16,906,445
Percent funded	74.5%	73.8%	73.0%
Unfunded (overfunded) actuarial accrued liability (UAAL)	4,403,454	4,178,762	4,567,549
Annual covered payroll	6,171,618	6,240,183	6,964,691
UAAL as a percentage of covered payroll	71.4%	67.0%	65.6%
Net pension obligation (NPO at the beginning of period)	-	-	-
Annual Pension Cost:			
Annual required contribution (ARC)	792,580	874,475	926,156
Interest on NPO	-	-	-
Adjustment to the ARC	792,580	874,475	926,156
Contributions made	792,580	874,475	926,156
Increase in NPO	-	-	-
NPO at the end of the period	\$ -	\$ -	\$ -

The City of Terrell is one of 811 municipalities having the benefit plan administered by TMRS. Each of the 811 municipalities has an annual, individual actuarial valuation performed. All assumptions for the December 31, 2005, valuations are contained in the 2005 TMRS Comprehensive Annual Financial Report, a copy of which may be obtained by writing to P. O. Box 149153, Austin, Texas 78714-9153.

Actuarial Assumptions

Actuarial Cost Method	-	Unit Credit
Amortization Method	-	Level Percent of Payroll
Remaining Amortization Period	-	25 Years - Open Period
Asset Valuation Method	-	Amortized Cost (to accurately reflect the requirements of GASB Statement No. 25, paragraphs 36e and 138)
Amortization Period	-	Open
Investment Rate of Return	-	7%
Projected Salary Increases	-	None
Includes Inflation at	-	3.5%
Cost-of-living Adjustments	-	None

Risk Management

The City is exposed to risk of loss due to injuries incurred by employees while performing work-related duties. The City provides workers' compensation insurance coverage with the Texas Municipal League, which provides statutory coverage against potential losses.

The City is exposed to various risks of loss related to torts, damage to, and destruction of assets; errors and omissions and natural disasters. A comprehensive insurance plan for property and casualty and general liability coverage has been established with the Texas Municipal League.

(continued)

4. DETAILED NOTES ON ALL FUNDS (Continued)

Commitments

During the fiscal year ended September 30, 2005, the City entered into an agreement with North Texas Municipal Water District (the "District"). Under the agreement, the District has agreed to acquire property and construct a transmission line in order to sell water to the City. As part of the agreement, the project will be financed by a bond issue in the amount of \$12,470,000 issued in the name of the District. The District is responsible for the cost of the project only to the extent of the bond issue and any additional construction costs are the responsibility of the City. During the construction phase, the City is responsible for the monthly transfer of funds to the District in order to pay the debt service obligation of the bonds and to fund any necessary reserve funds established by the bond ordinance. Upon completion of the project, the rights, title and interest in the project will rest irrevocably with the City. This transaction shall result in the automatic sale and delivery of the project to the City in consideration of the agreement of the City to perform its obligations under the agreement.

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COMBINING STATEMENTS

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NONMAJOR GOVERNMENTAL FUNDS

Housing Rehabilitation and Ownership Assistance Fund – to account for federal block grants awarded by the Texas Department of Community Affairs for housing rehabilitation and first time home buyer assistance of privately owned dwellings by primarily low income citizens.

Tourism Fund – to account for expenditures designated for the promotion of local tourism. Resources are provided from the collection of hotel/motel occupancy tax revenues.

Payroll Fund – to account for the receipt and disbursement of payroll related transfers from other funds. The fund clears all employee paychecks, income tax withholding, social security and other payroll related disbursements.

Grant Fund – to account for receipt and disbursement of grant funds used to construct a new road to a new business.

Public Improvement District – to account for costs of street improvements to Airport Road. Financing is provided from \$3,500,000 note proceeds from a local bank through the Terrell Economic Development Corporation and \$1,000,000 in assessments of property owners for a portion of the cost.

Permanent Street Improvement Fund – to account for the cost of street improvements within the City. Financing is provided by the sale of general obligation bonds and assessments of property owners for a portion of the cost.

C.O. Tax and Revenue Series 2002 Fund – to account for construction projects funded by the Series 2002 bond issuance.

Infrastructure Improvements – to account for street and utility service construction for Pioneer Terraces multifamily housing subdivision.

Impact Fees Fund – to account for fees charged on developments in order to improve current existing infrastructure.

Park Land/Park Dedication Fees Fund – to account for fees charged on new residential construction for future parks development.

Debt Service Fund – to account for the accumulation of resources for payment of interest and principal on general obligation long-term bonded debt. A portion of the annual ad valorem tax levy is designated for debt service.

CITY OF TERRELL, TEXAS
COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
SEPTEMBER 30, 2006

	Housing Rehabilitation and Ownership Assistance	Tourism	Payroll	Grant
ASSETS				
Cash and cash equivalents	\$ 27	\$ 52,751	\$ 59,253	\$ 466,161
Taxes receivable, net	-	-	-	-
Due from other funds	-	-	-	-
Receivable from other governments	-	-	-	133,893
Special Assessments	-	-	-	-
	<u>27</u>	<u>52,751</u>	<u>59,253</u>	<u>600,054</u>
Total assets	\$ <u>27</u>	\$ <u>52,751</u>	\$ <u>59,253</u>	\$ <u>600,054</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ -	\$ 577	\$ 5,692	\$ -
Due to other funds	-	-	53,561	575,442
Deferred revenue	-	-	-	12,268
	<u>-</u>	<u>577</u>	<u>59,253</u>	<u>587,710</u>
Total liabilities	\$ <u>-</u>	\$ <u>577</u>	\$ <u>59,253</u>	\$ <u>587,710</u>
Fund balances:				
Reserved for:				
Debt service	-	-	-	-
Grants/donations	27	-	-	-
Capital projects	-	-	-	-
Unreserved	<u>-</u>	<u>52,174</u>	<u>-</u>	<u>12,344</u>
Total fund balances	<u>27</u>	<u>52,174</u>	<u>-</u>	<u>12,344</u>
Total liabilities and fund balances	\$ <u>27</u>	\$ <u>52,751</u>	\$ <u>59,253</u>	\$ <u>600,054</u>

Public Improvement District	Permanent Street Improvement	Certificates Obligation Tax and Revenue Series 2002	Infrastructure Improvements	Impact Fees	Park Land/Park Dedication Fees	Debt Service	Total Governmental Funds
\$ 13,158	\$ 523,460	\$ -	\$ 10	\$ 937,240	\$ 1	\$ 431,443	\$ 2,483,504
-	-	-	-	-	-	103,201	103,201
-	54,143	-	-	-	97,000	-	151,143
-	-	-	-	-	-	-	133,893
-	653,429	-	-	-	-	-	653,429
<u>\$ 13,158</u>	<u>\$ 1,231,032</u>	<u>\$ -</u>	<u>\$ 10</u>	<u>\$ 937,240</u>	<u>\$ 97,001</u>	<u>\$ 534,644</u>	<u>\$ 3,525,170</u>
\$ -	\$ 4,391	\$ 74,214	\$ -	\$ -	\$ -	\$ -	\$ 84,874
13,158	10,325	-	-	97,000	-	93,430	842,916
-	653,429	-	-	-	-	103,201	768,898
<u>13,158</u>	<u>668,145</u>	<u>74,214</u>	<u>-</u>	<u>97,000</u>	<u>-</u>	<u>196,631</u>	<u>1,696,688</u>
-	-	-	-	-	-	338,013	338,013
-	-	-	-	-	-	-	27
-	562,887	(74,214)	10	749,447	40,500	-	1,278,630
-	-	-	-	90,793	56,501	-	211,812
-	562,887	(74,214)	10	840,240	97,001	338,013	1,828,482
<u>\$ 13,158</u>	<u>\$ 1,231,032</u>	<u>\$ -</u>	<u>\$ 10</u>	<u>\$ 937,240</u>	<u>\$ 97,001</u>	<u>\$ 534,644</u>	<u>\$ 3,525,170</u>

CITY OF TERRELL, TEXAS

**COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES**

NONMAJOR GOVERNMENTAL FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Housing Rehabilitation and Ownership Assistance	Tourism	Payroll	Grant
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
REVENUES				
Ad valorem taxes	\$ -	\$ -	\$ -	\$ -
Hotel/Motel occupancy taxes	-	197,432	-	-
Intergovernmental	-	-	-	988,985
Charges for services	-	-	-	-
Interest	-	1,206	-	-
Street assessments	-	-	-	-
Miscellaneous	-	-	-	1,010
Total revenues	<u> -</u>	<u> 198,638</u>	<u> -</u>	<u> 989,995</u>
EXPENDITURES				
Current:				
General government	6,120	143,477	-	-
Public welfare	-	-	-	977,651
Principal	-	25,908	-	-
Interest and other charges	-	1,675	-	-
Total expenditures	<u> 6,120</u>	<u> 171,060</u>	<u> -</u>	<u> 977,651</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u> (6,120)</u>	<u> 27,578</u>	<u> -</u>	<u> 12,344</u>
OTHER FINANCING SOURCES (USES)				
Transfers out	<u> -</u>	<u> -</u>	<u> -</u>	<u> -</u>
Total other financing sources and uses	<u> -</u>	<u> -</u>	<u> -</u>	<u> -</u>
NET CHANGE IN FUND BALANCES	<u> (6,120)</u>	<u> 27,578</u>	<u> -</u>	<u> 12,344</u>
FUND BALANCES, BEGINNING	<u> 6,147</u>	<u> 24,596</u>	<u> -</u>	<u> -</u>
FUND BALANCES, ENDING	<u> 27</u>	<u> 52,174</u>	<u> -</u>	<u> 12,344</u>

<u>Public Improvement District</u>	<u>Permanent Street Improvement</u>	<u>Certificates Obligation Tax and Revenue Series 2002</u>	<u>Infrastructure Improvements</u>	<u>Impact Fees</u>	<u>Park Land/Park Dedication Fees</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,555,247	\$ 1,555,247
-	-	-	-	-	-	-	197,432
-	100,000	-	-	-	-	-	1,088,985
-	-	-	-	737,545	40,500	-	778,045
-	1,857	-	139	11,902	-	1,501	16,605
39,659	5,065	-	-	-	-	-	44,724
658	-	-	-	-	-	-	1,668
<u>40,317</u>	<u>106,922</u>	<u>-</u>	<u>139</u>	<u>749,447</u>	<u>40,500</u>	<u>1,556,748</u>	<u>3,682,706</u>
-	164,619	-	372	-	-	-	314,588
-	-	-	-	-	-	-	977,651
-	-	-	-	-	-	890,000	915,908
-	-	-	-	-	-	613,881	615,556
-	<u>164,619</u>	<u>-</u>	<u>372</u>	<u>-</u>	<u>-</u>	<u>1,503,881</u>	<u>2,823,703</u>
<u>40,317</u>	<u>(57,697)</u>	<u>-</u>	<u>(233)</u>	<u>749,447</u>	<u>40,500</u>	<u>52,867</u>	<u>859,003</u>
<u>(40,317)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(40,317)</u>
<u>(40,317)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(40,317)</u>
-	(57,697)	-	(233)	749,447	40,500	52,867	818,686
-	<u>620,584</u>	<u>(74,214)</u>	<u>243</u>	<u>90,793</u>	<u>56,501</u>	<u>285,146</u>	<u>1,009,796</u>
<u>\$ -</u>	<u>\$ 562,887</u>	<u>\$(74,214)</u>	<u>\$ 10</u>	<u>\$ 840,240</u>	<u>\$ 97,001</u>	<u>\$ 338,013</u>	<u>\$ 1,828,482</u>

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INTERNAL SERVICE FUNDS

Self-insurance Fund – to account for the receipt and disbursement of medical insurance expenditures and related transfers from other funds.

Equipment Replacement Fund – to account for the acquisition, maintenance and other operation expenses of the City's fleet assets. Revenues are generated from the rental of equipment to various departments within the City.

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CITY OF TERRELL, TEXAS
COMBINING STATEMENT OF NET ASSETS
INTERNAL SERVICE FUNDS
SEPTEMBER 30, 2006

	<u>Self- insurance</u>	<u>Equipment Replacement</u>	<u>Total</u>
ASSETS			
Current assets:			
Cash and cash equivalents	\$ -	\$ 551,678	\$ 551,678
Total current assets	<u>-</u>	<u>551,678</u>	<u>551,678</u>
Non-current assets:			
Capital assets:			
Vehicles and Equipment	-	3,675,733	3,675,733
Accumulated depreciation	<u>-</u>	<u>(1,901,160)</u>	<u>(1,901,160)</u>
Total non-current assets	<u>-</u>	<u>1,774,573</u>	<u>1,774,573</u>
Total assets	<u>\$ -</u>	<u>\$ 2,326,251</u>	<u>\$ 2,326,251</u>
LIABILITIES			
Current liabilities:			
Accounts payable	\$ 116,984	\$ 5,248	\$ 122,232
Due to other funds	376	-	376
Other accrued expenses	-	7,491	7,491
Compensated absences	-	9,067	9,067
Bonds, notes, and loans payable	<u>-</u>	<u>70,232</u>	<u>70,232</u>
Total current liabilities	<u>117,360</u>	<u>92,038</u>	<u>209,398</u>
Non-current liabilities:			
Bonds, notes and loans payable	<u>-</u>	<u>121,889</u>	<u>121,889</u>
Total non-current liabilities	<u>-</u>	<u>121,889</u>	<u>121,889</u>
Total liabilities	<u>117,360</u>	<u>213,927</u>	<u>331,287</u>
NET ASSETS			
Invested in capital assets, net of related debt	-	1,582,452	1,582,452
Unrestricted	<u>(117,360)</u>	<u>529,872</u>	<u>412,512</u>
Total net assets	<u>\$ (117,360)</u>	<u>\$ 2,112,324</u>	<u>\$ 1,994,964</u>

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CITY OF TERRELL, TEXAS

**COMBINING STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET ASSETS**

INTERNAL SERVICE FUNDS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

	<u>Self- insurance</u>	<u>Equipment Replacement</u>	<u>Total</u>
OPERATING REVENUES			
Charges for services	\$ -	\$ 1,310,000	\$ 1,310,000
Contributions	1,165,323	-	1,165,323
Miscellaneous	<u>156,202</u>	<u>16,365</u>	<u>172,567</u>
Total operating revenues	<u>1,321,525</u>	<u>1,326,365</u>	<u>2,647,890</u>
OPERATING EXPENSES			
Personnel services	-	183,785	183,785
Miscellaneous services	-	136,672	136,672
Administrative Fees	568,913	-	568,913
Repairs and maintenance	-	68,034	68,034
Supplies	-	284,560	284,560
Insurance claims and expenses	945,104	-	945,104
Depreciation	<u>-</u>	<u>296,361</u>	<u>296,361</u>
Total operating expenses	<u>1,514,017</u>	<u>969,412</u>	<u>2,483,429</u>
OPERATING INCOME (LOSS)	(192,492)	356,953	164,461
NON-OPERATING REVENUES (EXPENSES)			
Interest and investment revenue	474	6,604	7,078
Interest expense	-	(5,255)	(5,255)
Miscellaneous expenses	<u>-</u>	<u>(20,838)</u>	<u>(20,838)</u>
Total non-operating revenue (expenses)	<u>474</u>	<u>(19,489)</u>	<u>(19,015)</u>
CHANGE IN NET ASSETS	(192,018)	337,464	145,446
TOTAL NET ASSETS, BEGINNING	<u>74,658</u>	<u>1,774,860</u>	<u>1,849,518</u>
TOTAL NET ASSETS, ENDING	<u>\$ (117,360)</u>	<u>\$ 2,112,324</u>	<u>\$ 1,994,964</u>

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CITY OF TERRELL, TEXAS

COMBINING STATEMENT OF CASH FLOWS

INTERNAL SERVICE FUNDS

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006

	<u>Self-insurance</u>	<u>Equipment Replacement</u>	<u>Total</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers and users	\$ 1,321,525	\$ 1,326,365	\$ 2,647,890
Cash paid for services and insurance claims	(1,474,141)	-	(1,474,141)
Cash paid to suppliers for goods and services	-	(487,629)	(487,629)
Cash paid to employees for services	-	(183,848)	(183,848)
Net cash provided (used) by operating activities	<u>(152,616)</u>	<u>654,888</u>	<u>502,272</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Cash received from other funds	376	-	376
Cash paid to other funds	-	(363)	(363)
Net cash provided (used) for noncapital financing activities	<u>376</u>	<u>(363)</u>	<u>13</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Acquisition of capital assets	-	(285,099)	(285,099)
Principal paid on long-term debt	-	(74,602)	(74,602)
Interest and fiscal charges paid on debt	-	(5,255)	(5,255)
Net cash provided (used) by capital and related financing activities	<u>-</u>	<u>(364,956)</u>	<u>(364,956)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment earnings	474	6,604	7,078
Net cash provided by investing activities	<u>474</u>	<u>6,604</u>	<u>7,078</u>
INCREASE (DECREASE) IN CASH	<u>(151,766)</u>	<u>296,173</u>	<u>144,407</u>
CASH AND CASH EQUIVALENTS, BEGINNING	<u>151,766</u>	<u>255,505</u>	<u>407,271</u>
CASH AND CASH EQUIVALENTS, ENDING	<u>\$ -</u>	<u>\$ 551,678</u>	<u>\$ 551,678</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES			
Operating income (loss)	\$(192,492)	\$ 356,953	\$ 164,461
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	-	296,361	296,361
Increase (decrease) in accounts payable	39,876	3,181	43,057
Increase (decrease) in accrued liabilities	-	(1,544)	(1,544)
Increase (decrease) in compensated absences	-	(63)	(63)
Net cash provided (used) by operating activities	<u>\$(152,616)</u>	<u>\$ 654,888</u>	<u>\$ 502,272</u>

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SINGLE AUDIT SECTION

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
*GOVERNMENT AUDITING STANDARDS***

To the Honorable City Council
City of Terrell, Texas

We have audited the financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Terrell, Texas, as of and for the year ended September 30, 2006, which collectively comprise the City of Terrell, Texas' basic financial statements and have issued our report thereon dated April 13, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Terrell, Texas' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we considered to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Terrell, Texas' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the City of Terrell, Texas, in a separate letter dated April 13, 2007.

That report is intended solely for the information and use of management, City Council and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Pattillo, Brown + Hill, L.L.P.

April 13, 2007



PATTILLO, BROWN & HILL, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS ■ BUSINESS CONSULTANTS

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Honorable City Council
City of Terrell, Texas

Compliance

We have audited the compliance of the City of Terrell, Texas, with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133, Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2006. The City of Terrell, Texas' major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of Terrell, Texas' management. Our responsibility is to express an opinion on the City of Terrell, Texas' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Terrell, Texas' compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City of Terrell, Texas' compliance with those requirements.

In our opinion, the City of Terrell, Texas, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2006.

Internal Control Over Compliance

The management of the City of Terrell, Texas, is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of Terrell, Texas' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management, City Council, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Pattillo, Brown + Hill, L.L.P.

April 13, 2007

CITY OF TERRELL, TEXAS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

<u>Federal Grantor/Pass-through Grantor/ Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures</u>
<u>U. S. Department of Housing and Urban Development</u>			
Passed through Office of Rural Community Affairs:			
Community Development Block Grant's State Program	14.228	724012	\$ <u>11,000</u>
Total Passed through Office of Rural Community Affairs			<u>11,000</u>
Direct Programs:			
HOME Investment Partnerships Program	14.239	N/A	671,210
Section 8 Housing Choice Vouchers Program	14.871	TX493	<u>3,037,031</u>
Total Direct Programs			<u>3,708,241</u>
 Total U. S. Department of Housing and Urban Development			 <u>3,719,241</u>
<u>U. S. Department of Justice</u>			
Direct Programs:			
Edward Byrne Memorial Justice Assistance Program	16.738	2005-DJ-BX-0113	<u>20,350</u>
Total Direct Programs			<u>20,350</u>
 Total U. S. Department of Justice			 <u>20,350</u>
<u>Department of Homeland Security</u>			
Direct Programs:			
Public Assistance - Katrina	97.036	FEMA 3216 EM	232,773
Assistance to Fire Fighters Grant	97.044	EMW-2005-FG-08185	<u>95,960</u>
Total Direct Programs			<u>328,733</u>
 Total Department of Homeland Security			 <u>328,733</u>
 Total Expenditures of Federal Awards			 <u>\$ 4,068,324</u>

CITY OF TERRELL, TEXAS

NOTES TO SCHEDULE OF FEDERAL AWARDS

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006

BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the City of Terrell presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

CITY OF TERRELL, TEXAS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED SEPTEMBER 30, 2006

Summary of Auditors' Results

Type of report on financial statements	Unqualified
Internal control over financial reporting: Material weakness(es) identified?	No
Reportable condition(s) identified that are not considered to be material weakness(es)?	None reported
Internal control over major programs: Material weakness(es) identified?	No
Reportable condition(s) identified that are not considered to be material weakness(es)?	None reported
Noncompliance which is material to the basic financial statements	None
Type of report on compliance with major programs	Unqualified
Findings and questioned costs for federal awards as defined in Section 501(a), OMB Circular A-133 disclosed	None
Dollar threshold considered between Type A and Type B federal programs	\$300,000
Low risk auditee statement	The City was classified as a low-risk auditee in the context of OMB Circular A-133
Major federal programs	Section 8 Rental Voucher Program, CFDA #14.871 Home Investment Partnership Program, CFDA #14.239

**Findings Relating to the Financial Statements Which are
Required to be Reported in Accordance With Generally
Accepted Auditing Standards**

None

Findings and Questioned Costs for Federal Awards

None

CITY OF TERRELL, TEXAS
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
YEAR ENDED SEPTEMBER 30, 2006

None